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May 30, 2000

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Application of Memphis Networx, LLC, for a Certificate of Public Convenience and Necessity to Provide Intrastate Telecommunication Services and Joint Petition of Memphis Light Gas & Water Division, A Division of the City of Memphis, Tennessee ("MLGW") and A&L Networks-Tennessee, LLC ("A&L"), for Approval of Agreement Between MLGW and A&L Regarding Joint Ownership of Memphis Networx, LLC

Docket No. 99-00909

Dear Mr. Waddell:

I have enclosed an original and thirteen copies of Direct Testimony of Consumer Advocate Division witness Archie R. Hickerson, Director in the above referenced matter. Copies are being furnished to counsel of record for interested parties.

Sincerely,

A handwritten signature in cursive script, reading "Vance L. Broemel".

Vance L. Broemel
Assistant Attorney General

c: Counsel of record

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POSTED
6-1-00

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE: APPLICATION OF MEMPHIS NETWORKX, LLC, FOR A
CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY
TO PROVIDE INTRASTATE TELECOMMUNICATION
SERVICES AND JOINT PETITION OF MEMPHIS LIGHT GAS
& WATER DIVISION, A DIVISION OF THE CITY OF
MEMPHIS, TENNESSEE ("MLGW") AND A&L NETWORKS-
TENNESSEE, LLC ("A&L"), FOR APPROVAL OF
AGREEMENT BETWEEN MLGW AND A&L REGARDING
JOINT OWNERSHIP OF MEMPHIS NETWORKX, LLC
DOCKET NO. 99-00909

DIRECT TESTIMONY
of
ARCHIE R. HICKERSON

May 30, 2000

1 Q. What is your name, by whom are you employed, and what is your address?

2
3 A. My name is Archie Hickerson and I am the Director of the Consumer Advocate
4 Division Staff in the Office of the Attorney General for the State of Tennessee. My
5 business address is 2nd Floor, Cordell Hull Building, 425 5th Ave. N, Nashville
6 Tennessee, 37243-0500.

7
8 Q. What is your educational background, and what licenses and professional
9 memberships do you hold?

10
11 A. I have a bachelor of science degree from Austin Peay State University with
12 majors in mathematics and accounting. I am a licensed Certified Public Accountant in
13 the State of Tennessee and I am a member of the American Institute of Certified Public
14 Accountants (AICPA). I am also a member of the National Association of State
15 Consumer Advocate's (NASUC's) Accounting and Tax Committee, and an observer
16 member of the National Association of Regulatory Commissioners (NARUC)
17 Subcommittee on Accounts.

18
19 Q. What is your work experience concerning the regulation of utilities?

20
21 A. For 18 years I worked for the Tennessee Public Service Commission. In 1976, I

1 began as a financial analyst in the Commission's Accounting Division. As an analyst I
2 audited utilities' books and records, analyzed public utilities' cost of providing service,
3 developed financial exhibits, and entered testimony sponsoring these exhibits in rate
4 proceedings before the Commission. I was promoted to Assistant Director of the
5 Accounting Division, and became the Deputy Director of the Utility Rate Division after
6 the Accounting and the Utility Rate Divisions were combined. As the Assistant Director
7 and later the Deputy Director, I supervised the employees who conducted compliance
8 audits of utilities, made earning and rate investigations, reviewed tariff filings,
9 supervised management audits, and supervised investigations as requested by the
10 Commission. I directly participated in rate proceedings, worked in the development of
11 Commission administrative rules and regulations, and prepared and filed comments in
12 proceedings before the Federal Communications Commission (FCC), and the Internal
13 Revenue Service. I also reviewed depreciation studies submitted by the regulated
14 utilities, and along with the Director of Telecommunications, negotiated depreciation
15 rates with the representatives of the utilities and the FCC. As part of my duties with the
16 Commission, I served as a member of the National Association of Regulatory Utility
17 Commissioners' (NARUC) Staff Subcommittee on Communications, the NARUC
18 Subcommittee on Accounts, and the Southern Accounting Task Force.

19 When the General Assembly created the Consumer Advocate Division within the
20 Attorney General's Office effective July 1, 1994, I became the Director of the Consumer
21 Advocate Staff. My duties and responsibilities in the Consumer Advocate Division are

1 basically the same as when I was employed by the Commission.

2
3 Q. As part of your course of study to obtain an accounting degree, were you required
4 to complete courses in accounting, business, economics, and business law?

5
6 A. Yes.

7
8 Q. In order to become a Certified Public Accountant were you required to
9 demonstrate proficiency in the activities normally engaged in by Certified Public
10 Accountants by passing an examination that covered accounting theory, auditing, practice
11 problems, and business law?

12
13 A. Yes.

14
15 Q. As a Certified Public Accountant, are you required to meet minimum continuing
16 professional educational requirements and have you participated in both accounting and
17 legal continuing education workshops and courses?

18
19 A. Yes.

20
21 Q. What do you intend to address in your testimony in this proceeding?

1 A. I will represent the Tennessee Consumers through, the Consumer Advocate
2 Division and give an opinion on Memphis Light Gas and Water's (MLGW's) procedure
3 for identifying and allocating costs to its Telecommunications Division and ultimately to
4 Memphis Networkx.

5
6 Q. What is Consumer Advocate Division's concerns with MLGW's identification
7 and allocating costs to the Telecommunication Division and Memphis Networkx?

8
9 A. The Division's primary concern is that the telephone operation not be subsidized
10 by the customers of MLGW's electric, water, and natural gas divisions that provide
11 monopoly service.

12
13 Q. Does the Tennessee Code address the allocation of cost by a municipal owned
14 electric utility that also provides telecommunications in accordance with Tenn. Code
15 Ann. §7-52-401?

16
17 A. Yes. Tenn. Code Ann. § 7-52-402 provides that:

18 A municipality providing any of the services authorized by
19 § 7-52-401 **shall not provide subsidies for such services.**
20 Notwithstanding the limitations set forth in the preceding
21 sentence, a municipality providing such services shall be
22 authorized to:

23 (1) Dedicate a reasonable portion of the electric
24 plant to the provision of such services, the costs of
25 which shall be allocated to such services for

1 regulatory purposes; and
2 (2) Lend funds, at a rate of interest not less than the
3 highest rate then earned by the municipality on
4 invested electric plant funds, to acquire, construct,
5 and provide working capital for the system, plant,
6 and equipment necessary to provide any of the
7 services authorized under § 7-52-401; provided, that
8 such interest costs shall be allocated to the cost of
9 such services for regulatory purposes. Any loan of
10 funds made pursuant to this section shall be
11 approved in advance by the state director of local
12 finance and shall contain such provisions as are
13 required by the state director. (Emphasis added.)
14

15 These provisions specifically prohibits the subsidization of telecommunication
16 services by the electric operations.

17 Even if the statute did not prohibit such subsidization, regulatory principles and
18 theory require that monopoly electric, natural gas, and water utility operations not bear
19 the cost incurred by MLGW in providing competitive telecommunications services. To
20 allow such subsidization would harm the customers of the monopoly operations and
21 could be detrimental to the development of competition in the local telecommunications
22 market.
23

24 Q. You stated that regulatory principles and theory require that monopoly electric,
25 natural gas, and water utility operations not bear the cost incurred by MLGW in
26 providing competitive telecommunications services. Have regulators developed rules
27 and adopted principles that address the allocation of costs where an entity such as MLGW
28 is engaged in the provision of both monopoly and competitive services?

1 A. Yes. Various regulatory agencies have developed cost allocation rules and
2 guidelines. Specific examples are the Federal Communications Commission's (FCC's)
3 Cost Allocation Rules (47 CFR § 64.901; 64.902; 64.903; & 64.904); the FCC's
4 Affiliate Transactions Rules (47 CFR § 32.27), and the National Association of
5 Regulatory Utility Commission's (NARUC's) Cost Allocation and Affiliate Transactions
6 Guidelines for the Energy Industry.

7 The FCC's Affiliate Transactions Rules are applicable to Local Exchange
8 Companies such as BellSouth, and Sprint United Telephone Southeast. These rules that
9 are incorporated into the FCC's Uniform System of Accounts often referred to as Part 32,
10 which has been adopted by the Tennessee Regulatory Authority in its Administrative
11 Rule 1220-4-1-.11(1) UNIFORM SYSTEM OF ACCOUNTING. The affiliate
12 transactions rules control the recording of transactions that occur between a regulated
13 telephone utility and it affiliates.

14 The FCC cost allocation rules in Part 64 addresses the assignment of cost where a
15 regulated utility provides both monopoly and non-regulated services within the same
16 entity. An example is BellSouth's provision of voice mail (Memory Call) service that is
17 classified a non-regulated service by the FCC. In accordance with the FCC's cost
18 allocation rules, BellSouth must identify and exclude from its cost of providing regulated
19 service the fully allocated cost of providing Memory Call service.

20 The purpose of these rules is to protect the telephone customers from the improper
21 subsidization of competitive operations.

1
2 Q. Do these rules provide specific procedures for identifying and assigning cost?

3
4 A. The rules are quite specific. The **affiliate transaction rules** require that tariffed
5 services be provided at tariffed rates. Non-tariffed services provided by the regulated
6 utility to a non-regulated affiliate are to be priced at the **greater** of cost or prevailing
7 market price. Services provided by the non-regulated affiliate to the utility are to be
8 priced at the **lower** of cost or prevailing market price¹.

9 The **cost allocation** rules provide:

10 **Sec. 64.901 Allocation of costs.**

11
12 (a) Carriers required to separate their regulated costs from
13 nonregulated costs shall use the attributable cost method of cost allocation
14 for such purpose.

15
16 (b) In assigning or allocating costs to regulated and nonregulated
17 activities, carriers shall follow the principles described herein.

18 (1) Tariffed services provided to a nonregulated activity will be charged to
19 the nonregulated activity at the tariffed rates and credited to the regulated
20 revenue account for that service.

21 (2) Costs shall be directly assigned to either regulated or nonregulated
22 activities whenever possible.

23 (3) Costs which cannot be directly assigned to either regulated or
24 nonregulated activities will be described as common costs. Common costs
25 shall be grouped into homogeneous cost categories designed to facilitate
26 the proper allocation of costs between a carrier's regulated and
27 nonregulated activities. Each cost category shall be allocated between
28 regulated and nonregulated activities in accordance with the following
29 hierarchy:

30 (i) Whenever possible, common cost categories are to be allocated
31 based upon direct analysis of the origin of the cost themselves.

¹Prevailing market price applies only when 50% of the service is provided to a nonrelated third party.

1 (ii) When direct analysis is not possible, common cost categories
2 shall be allocated based upon an indirect, cost-causative linkage to
3 another cost category (or group of cost categories) for which a
4 direct assignment or allocation is available.

5 (iii) When neither direct nor indirect measures of cost allocation
6 can be found, the cost category shall be allocated based upon a
7 general allocator computed by using the ratio of all expenses
8 directly assigned or attributed to regulated and nonregulated
9 activities.

10 (4) The allocation of central office equipment and outside plant investment
11 costs between regulated and nonregulated activities shall be based upon
12 the relative regulated and nonregulated usage of the investment during the
13 calendar year when nonregulated usage is greatest in comparison to
14 regulated usage during the three calendar years beginning with the
15 calendar year during which the investment usage forecast is filed.

16
17 (c) **A telecommunications carrier may not use services that are not**
18 **competitive to subsidize services subject to competition.** Services included in
19 the definition of universal service shall bear no more than a reasonable share of
20 the joint and common costs of facilities used to provide those services. (Emphasis
21 added.)

22
23 While the rules are specific concerning the principles to be applied, the mechanics
24 of the allocation process (development of allocation factors and procedures to identify
25 and allocate costs) are generally left to the utility in the development of Cost Allocation
26 Manuals (CAMs).
27

28
29 Q. Are the NARUC Guidelines consistent with the principles that are the basis of the
30 FCC affiliate transaction and cost allocation rules?

31
32 A. Yes. The principles are consistent.
33

1 Q. Are the NARUC Guidelines, “rules” that must be followed by the Tennessee
2 Regulatory Authority?

3
4 A. No. The NARUC Guidelines are “guidelines” and do not have the force of a rule.
5 The following is quoted from the Guidelines Adopted by Resolution at NARUC’s 1999
6 Summer meeting.

7
8 The following Guidelines for Cost Allocations and Affiliate
9 Transactions (Guidelines) are intended to provide guidance to
10 jurisdictional regulatory authorities and regulated utilities and their
11 affiliates in the development of procedures and recording of
12 transactions for services and products between a regulated entity
13 and affiliates. The prevailing premise of these Guidelines is that
14 allocation methods should not result in subsidization of
15 non-regulated services or products by regulated entities unless
16 authorized by the jurisdictional regulatory authority. These
17 Guidelines **are not intended to be rules or regulations**
18 **prescribing how cost allocations and affiliate transactions are**
19 **to be handled. They are intended to provide a framework for**
20 **regulated entities and regulatory authorities in the**
21 **development of their own policies and procedures for cost**
22 **allocations and affiliated transactions.** Variation in regulatory
23 environment may justify different cost allocation methods than
24 those embodied in the Guidelines. (Emphasis added.)

25
26 The Guidelines acknowledge and reference the use of several
27 different practices and methods. It is intended that there be latitude
28 in the application of these guidelines, subject to regulatory
29 oversight. The implementation and compliance with these cost
30 allocations and affiliate transaction guidelines, by regulated
31 utilities under the authority of jurisdictional regulatory
32 commissions, is subject to Federal and state law. Each state or
33 Federal regulatory commission may have unique situations and
34 circumstances that govern affiliate transactions, cost allocations,
35 and/or service or product pricing standards. For example, The

1 Public Utility Holding Company Act of 1935 requires registered
2 holding company systems to price "at cost" the sale of goods and
3 services and the undertaking of construction contracts between
4 affiliate companies.
5

6
7 Q. Do you agree with the NARUC Guidelines?
8

9
10 A. Yes. I agree with the guidelines. I worked with the members of the NARUC

11 Staff Subcommittee on Accounts in the development of the Guidelines and appeared on
12 behalf of the National Association of State Consumer Advocates (NASUCA) in support
13 of the guidelines before the NARUC Commissioners who reviewed and developed the
14 version of the guidelines that was ultimately adopted by the NARUC.
15

16 Q. In you opinion, are the NARUC Guidelines appropriate for Memphis Light Gas
17 and Water?
18

19 A. Yes. The NARUC Guidelines are appropriate in this instance. MLGW's Eclectic
20 Division is a monopoly provider of electric energy in the Memphis area. As explained by
21 the witnesses for MLGW, the Telecommunication Division is actually a subdivision of
22 MLGW's Electric Division, and Memphis Networkx is an affiliate. While the FCC's Cost
23 Allocation and Affiliate Transaction Rules are to protect the ratepayers of regulated local
24 telephone companies, the NARUC Guidelines were developed and adopted in an attempt
25 to help protect the customers of monopoly energy providers that elect to also participate
26 in non-regulated and/or competitive operations. In this instance, MLGW's Electric

1 Division is such a monopoly energy provider and its Telecommunication Division will
2 hold an investment in Memphis Networkx, an affiliate proposing to enter the competitive
3 telecommunication market.

4
5 Q. Does it matter that Memphis Networkx is now proposing not to enter the retail
6 market but to be only a carriers' carrier?

7
8 A. No. As a "carriers' carrier," Memphis Networkx will not be competing at the retail
9 level but will be competing with BellSouth and possibly other carriers in providing
10 facilities at the wholesale level to other carriers that use those facilities to provide service.

11
12 Q. Have you reviewed the Pre-Filed testimony filed on behalf of MLGW?

13
14 A. Yes.

15
16 Q. Do you understand that the Telecommunication Division "is essentially an
17 accounting devise that MLGW has created as a division within its Electric Division" to
18 hold "MLGW's investment in Memphis Networkx" and act "as an accounting entity to
19 capture any MLGW internal costs related to MLGW's involvement in the formation and
20 operation of Memphis Networkx."²

² Pre-filed supplemental testimony of John McCullough on behalf of MLGW page 2.

1 A. Yes. Based on the explanation provided by MLGW witnesses McCullough and
2 Whittin, I understand that the internal cost incurred by MLGW relative to the
3 telecommunications operations will be collected and accounted for within the
4 Telecommunications Division, and that the Telecommunications Division will receive
5 distribution from Memphis Network that will be used to repay inter-division loans and
6 costs reimburse MLGW for any costs allocated to the Telecommunications Division.

7
8 Q. Do you understand that less than 15 MLGW employees have participated in the
9 telecommunications project and that MLGW has directly assigned a portion of these
10 employees compensation and related overheads to the Telecommunications Division?

11
12 A. This was explained by both Mr. McCullough in his pre-filed supplemental
13 testimony and Mr. Whitten in their pre-filed testimony. I am assuming that their
14 testimony is accurate.

15
16 Q. Is this approach consistent with the NARUC Guidelines?

17
18 A. Based on the testimony, I understand that MLGW has specifically identified these
19 individuals as performing functions involving the management of MLGW's investment
20 in the Memphis Network's entry into the telecommunications market. The cost (payroll,
21 and overheads) related to the time that these individuals have devoted to the project has

1 been directly assigned to MLGW's Telecommunication Division. If my understanding is
2 correct, this is consistent with the first principle listed in the NARUC cost allocation
3 guidelines:

4 1. To the maximum extent practicable, in consideration of
5 administrative costs, costs should be collected and classified on a
6 direct basis for each asset, service or product provided.
7
8
9

10
11 Q. Do you know if MLGW intends to continue to directly assign the cost incurred
12 by those MLW employees directly involved with the management of MLGW's
13 investment in Memphis Networkx to the Telecommunication Division?
14

15 A. Again, based on MLGW's witnesses' testimony, I understand that MLGW
16 intends to continue to directly assign, to the Telecommunications Division, the cost of
17 the 11 MLGW employees who will be involved in the oversight of the Memphis Networkx
18 operation. I understand the Telecommunications Division is not an operating division as
19 are the Electric, Water, and Gas Divisions. The Telecommunications Division could be
20 characterized as a paper entity or a set of accounts that exist simply to record MLGW's
21 cost incurred in the management of its investment in Memphis Networkx. The division
22 will have no employees, will provide no direct input into the daily operations of
23 Memphis Networkx, and will provide no services other than general oversight of the
24 investment.
25

1 Q. Should only the payroll cost for the employees directly involved in the oversight
2 of Memphis Networx be directly assigned to the Telecommunication Division?

3
4 A. No. The assigned cost should include the payroll cost and all related overheads
5 consistent with the principle that cost should be assigned on a fully allocated basis. The
6 development of the overhead factors used to assign costs to the Telecommunications
7 Division should be clearly specified in the Cost Allocation Manual.

8
9 Q. Is it necessary that MLGW have an elaborate cost allocation procedure to capture
10 the cost that is incurred in the oversight of its investment in the telephone operations?

11
12 A. No. It is not necessary that the procedure used to identify and properly assign
13 such costs be elaborate. The procedures or system for capturing such cost must be
14 evaluated from a cost/benefit and common sense perspective. It does not make sense to
15 adopt procedures that result in the utility incurring more cost than is necessary to
16 reasonable identify the cost incurred in the non-regulated and/or competitive operations.
17 The procedures that are implemented should be reduced to writing in the form of a Cost
18 Allocation Manual (CAM) that provides sufficient details that will allow MLGW
19 employees, and third parties to clearly understand the procedures used to identify and
20 assign costs. Each page of the manual should clearly show the effective date, and all
21 changes to the manual should be documented. In addition the utility's and Memphis

1 Network's records should be maintained as to allow the allocations to be audited and
2 reviewed by the Authority, or other interested parties to insure that costs are properly
3 assigned so that the customers of MLGW's monopoly electric, gas, and water operations
4 do not bear the cost of MLGW's entry into the competitive telecommunications market.
5 This is consistent with the NARUC Guidelines' audit requirements which provide:
6

7 E. AUDIT REQUIREMENTS 8

9 1. An audit trail should exist with respect to all transactions
10 between the regulated entity and its affiliates that relate to
11 regulated services and products. The regulator should have
12 complete access to all affiliate records necessary to ensure that cost
13 allocations and affiliate transactions are conducted in accordance
14 with the guidelines. Regulators should have complete access to
15 affiliate records, consistent with state statutes, to ensure that the
16 regulator has access to all relevant information necessary to
17 evaluate whether subsidization exists. The auditors, not the audited
18 utilities, should determine what information is relevant for a
19 particular audit objective. Limitations on access would
20 compromise the audit process and impair audit independence.
21

22 2. Each regulated entity's cost allocation documentation should be
23 made available to the company's internal auditors for periodic
24 review of the allocation policy and process and to any
25 jurisdictional regulatory authority when appropriate and upon
26 request.
27

28 3. Any jurisdictional regulatory authority may request an
29 independent attestation engagement of the CAM. The cost of any
30 independent attestation engagement associated with the CAM,
31 should be shared between regulated and non-regulated operations
32 consistent with the allocation of similar common costs.
33

34 4. Any audit of the CAM should not otherwise limit or restrict the
35 authority of state regulatory authorities to have access to the books
36 and records of and audit the operations of jurisdictional utilities.

1 5. Any entity required to provide access to its books and records
2 should make arrangements as necessary and appropriate to ensure
3 that competitively sensitive information derived therefrom be kept
4 confidential by the regulator.
5

6 In this case, since MLGW is a public entity and, therefore subject to the public
7 records act, I would expect Memphis Network's records should also be treated as public
8 records. This would make review and oversight by third parties easier.
9

10 Q. As presented by the MLGW witnesses in this proceeding, does it appear
11 reasonable to utilize the direct assessment method to assign cost to MLGW's
12 Telecommunication Division?
13

14 A. Based on the pre-filed testimony, MLGW will have a minimal involvement with
15 the operation of Memphis Network. As a result, it appears reasonable that cost be
16 directly assigned. In discussing the allocation of cost between MLGW and Memphis
17 Network, Mr. McCullough reported that "less than fifteen employees have done work on
18 the telecommunications project." Later in discussing the allocation of MLGW's internal
19 cost after certification of Memphis Network, Mr. McCullough states:

20 In my view, these internal costs will be very insignificant. In fact,
21 the only costs that I foresee are cost allocations for the time that
22 MLGW's executives spend serving as Governors on the Memphis
23 Network Board of Governors and for the time that MLGW's
24 executives spend on matters relating to MLGW's current and
25 future investments in Memphis Network. Once Memphis Network
26 is operational, I anticipate that less than five percent (5%) of these
27 employees' time will be devoted to those functions. Of course, if
28

1 their actual time is greater than anticipated, these costs will be
2 captured in accordance with MLGW's cost allocation process.

3
4 The MLGW employees that will be involved in the oversight and operation of
5 Memphis Networkx should be specifically identified, their specific duties and
6 responsibilities relate to MLGW and Memphis Networkx should be delineated, and the
7 time each devotes to Memphis Networkx disclosed.

8
9 Q. Should MLGW provide periodic reports to the Authority concerning the
10 assignment of cost to the telecommunications operations?

11
12 A. Yes, and MLGW has agreed to provide such a report. On page 4 of his pre-filed
13 supplemental testimony Mr. McCullough explains:

14 Upon successful completion of the application process before TRA,
15 MLGW will require its external audit firm (currently Deloitte-Touche) to
16 expand or modify its annual process to comply with the requirements for a
17 "cost allocation compliance" audit, including the issuance of an opinion on
18 such compliance.

19
20 Similarly Mr. Whitten testifies on page 5 of his testimony that:

21
22 Yes. MLGW, upon successful completion of the application process before TRA,
23 will require its external audit firm (currently Deloitte-Touche) to expand or
24 modify its annual audit procedures to comply with the requirements for a "cost
25 allocation compliance" audit, including the issuance of an opinion on such
26 compliance.

27
28 Q. Should these reports address only MLGW's allocation of cost to its
29 Telecommunications Division or should it also address other transactions between
30 MLGW and Memphis Networkx as well?

- 1 A. The report should address both MLGW's allocation of cost to its
2 Telecommunications Division as well as the other transactions between MLGW and
3 Memphis Networkx. The reports should, at a minimum:
- 4 • identify the functions performed by MLGW's Telecommunications
5 Division,
 - 6 • the amount and type of costs allocated to the Telecommunications
7 Division from MLGW,
 - 8 • a description of the methods and procedure used to identify and allocate
9 such costs,
 - 10 • a list of tariffed service provided by each of MLGW's other divisions to
11 Memphis Networkx,
 - 12 • the dollar amount of such transactions,
 - 13 • a list of non-tariffed services provided to Memphis Networkx by MLGW,
 - 14 • the dollar amount of such transactions,
 - 15 • the method used to determine the price of such services (i.e. cost,
16 prevailing market price, etc.)
 - 17 • a list of services provided to MLGW by Memphis Networkx,
 - 18 • the dollar amount of each such service provided to MLGW by Memphis
19 Networkx, and
 - 20 • the method used to determine the price of such services (i.e. cost,
21 prevailing market price, etc.)

1
2 Q. Is it your understanding that MLGW foresees a very small volume of transactions
3 between MLGW and Memphis Networkx?
4

5 A. That is my understanding. On page 5 of his pre-filed supplemental testimony, Mr.
6 McCullough explains:

7 When we originally looked at this issue, we did not see many non-tariffed
8 transactions between MLGW and Memphis Networkx other than pole
9 attachments and conduit rental arrangements, which we will handle under
10 the statutory standard established in T.C.A § 7-52-405. Therefore, we
11 believed and continue to believe that the minimal number and value of
12 other non-tariffed affiliate transactions are not sufficient to justify
13 developing and administrating the more detailed affiliate transaction
14 policy prescribed by the FCC Affiliate Transactions Rules.
15

16 Q. Do you agree or disagree with Mr. McCullough?
17

18 A. Since I do not know the type or level of non-tariffed transactions that are likely to
19 occur between MLGW and Memphis Networkx, I can neither agree nor disagree. If I
20 accept the premise that the volume and value of transactions are immaterial, I agree that
21 the development of more detailed and costly accounting procedures may not be justified.
22 If the non-tariffed transactions become material, accounting procedures consistent with
23 the general requirements of the NARUC Affiliate Transaction Guidelines should be
24 developed. I have previously recommended that the TRA require the annual reports
25 from MLGW that identify the level of both tariffed and non-tariffed transactions. If the

1 Authority determines that the transactions are material, it can direct that the accounting
2 procedures be modified.

3
4 Q. How should the transfer of capital assets be recorded?

5
6 A. The NARUC Guidelines provide:

7 Generally, transfer of a capital asset from the utility to its non-regulated
8 affiliate should be at the greater of prevailing market price or net book
9 value, except as otherwise required by law or regulation. Generally,
10 transfer of assets from an affiliate to the utility should be at the lower of
11 prevailing market price or net book value, except as otherwise required by
12 law or regulation. To determine prevailing market value, an appraisal
13 should be required at certain value thresholds as determined by regulators.

14
15 Unlike services provided by either MLGW to Memphis Networkx or by Memphis
16 Networkx to MLGW, detailed cost studies should not be required to determine the book
17 cost of capital assets that are transferred. The book cost of such assets should be readily
18 available directly from the books and records. As a result, the standard for recording such
19 transactions should be the greater of book or market value when MLGW transfers an
20 asset to Memphis Networkx, and the lower of book or market value when Memphis
21 Networkx transfers a capital asset to MLGW.

22
23 Q. Mr. McCullough and Mr. Stinson testify that MLGW will charge Memphis
24 Networkx the highest rate for pole attachments and underground installations as it charges
25 any third party under comparable agreements. Do you agree that this pricing procedure

1 is appropriate?

2
3 A. Yes. Tenn. Code Ann § 7-52-405 provides:

4 For regulatory purposes, a municipality shall allocate to the costs of
5 providing any of the services authorized by § 7-52-401:

6 (1) An amount for **attachments to poles owned by the municipality**
7 **equal to the highest rate charged by the municipality to any other**
8 **person or entity for comparable pole attachments; and**

9 (2) Any applicable rights-of-way fees, rentals, charges, or payments
10 required by state or local law of a nongovernmental corporation that
11 provides the identical services. (Emphasis added.)
12

13 It is clear that the statute requires MLGW to charge Memphis Networkx the highest
14 rate it charges any other non-related party for pole attachments. Although the statute only
15 requires MLGW to charges its affiliate the highest rate that it charges a nonrelated party
16 for pole attachments, MLGW's proposed pricing of access to its underground facilities is
17 consistent with the principle inherent in the statute.
18

19 Q. On page 13 of his pre-filed supplemental testimony, Mr. McCullough explains
20 that:

21 MLGW will bid on construction activities for Memphis Networkx. MLGW
22 will establish its bid price based on no less than its calculation of fully
23 allocated cost of the project, and MLGW would perform similar services
24 for unaffiliated third parties using the same minimum pricing
25 methodology. This bid price, assuming that Memphis Networkx awards the
26 contract to MLGW, will also represent fair market value for those services.
27

28 Do you agree that this approach will automatically result in pricing that represents
29 the fair market value for the service provided?

1 A. No. While the use of the full allocated cost as the lower limit on such projects is
2 consistent with the NARUC Guidelines, the bid process will not necessarily result in the
3 price being the fair market price. For example, MLGW could very well make a bid that
4 would be above fully allocated cost but below fair market value. MLGW could bid
5 above fully allocated cost and still bid less than fair market value in order to win the
6 project. I note that Mr. McCullough states that; “. . . MLGW would perform similar
7 services for unaffiliated third parties using the same **minimum pricing methodology.**”
8 In other words, MLGW will not bid below fully allocated cost on a project that it will
9 perform for an unaffiliated third party. He does not state that MLGW will not bid lower
10 for projects that it does for Memphis Networkx than it would bid on a similar project for
11 an unrelated third party. As a result, I recommend that the Authority monitor MLGW’s
12 construction for Memphis Networkx using the annual cost allocation and affiliate
13 transaction report to monitor the level of construction activities to determine if a further
14 investigation is warranted to determine if MLGW’s monopoly electric, gas, and water
15 customers are being fairly compensated for the construction work performed for
16 Memphis Networkx.

17
18 Q. In your opinion will Memphis Networkx’s operation of a carriers carrier network
19 benefit the development of competition?

20
21 A. I believe it will. Presently there is one major local telephone network in

1 Memphis that is owned by the incumbent carrier, BellSouth³. A competitive carrier that
2 enters the local Memphis telephone market generally must build facilities or purchase the
3 use of facilities from a competitor. A carriers' carrier such as Memphis Networx should
4 provide an alternative. By using the facilities of Memphis Networx, the smaller carriers
5 will not be required to raise the large amount of capital needed to finance network
6 facilities needed to compete. As a result competitive carriers' entry into the Memphis
7 local telephone market should be easier and attractive to a greater number of prospective
8 competitors.

9
10 Q. Does this complete your testimony?

11
12 A. Yes.

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³ Other carriers such as Time Warner have facilities within the Memphis market, but not the extensive network operated by BellSouth. A small competitive carrier (CLEC) could possibly purchase use of some facilities from another facility based carrier such as Time Warner.

Certificate of Service

I hereby certify that a true and correct copy of the foregoing Direct Testimony of Archie R. Hickerson was served on parties of record via U.S. Mail, postage prepaid, this 30th day of May, 2000.

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